PSC NEWS
Missouri Public Service Commission

Contact: Kevin Kelly Phone: (573) 751-9300 *Governor Office Building, Suite 900*

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LACLEDE GAS CUSTOMERS TO RECEIVE $4.9 MILLION UNDER PSC DECISION

Jefferson City (May 2, 2003)---The Missouri Public Service Commission has determined that Laclede Gas Company is not entitled to retain approximately $4.9 million in proceeds from the sale of call options during the winter of 2000-2001 under the Overall Cost Reduction Incentive provisions of the Company's Price Stabilization Program. As a result, customers of the state's largest natural gas company will see their rates adjusted, subject to appeal or rehearing, over a 12 month period starting in the fall of this year to reflect the $4.9 million. The Commission's decision involves cases that examined Laclede Gas Company's natural gas purchases for the 1999-2000 and 2000-2001 winter seasons.

The adjustment ordered by the Commission in this case regards Laclede's Price Stabilization Program which was initially approved by the Commission in 1997. It was extended and modified under a Commission order in 1999. Under the program, Laclede was allowed to use up to $4 million per year of customer money to buy and sell call options as a means of hedging the price of its gas supply.

A call option is a financial instrument that gives the purchaser of the instrument the right, but not the obligation, to buy a futures contract for a specified price within a specified period of time. The purchaser buys the call option by paying a one-time premium. A call option specifies the price at which the underlying futures contract may be purchased if the call option is exercised (called a strike price). For a natural gas company, the trading of call options can be used to hedge the price of natural gas, providing a measure of protection for its customers against increasing costs of natural gas.

Laclede's Price Stabilization Program contained two incentive components as a means to ensure Laclede used its customers' money wisely. The Price Protection Incentive component was designed to encourage Laclede to get as low a strike price as it could. The second component, the Overall Cost Reduction Incentive, was designed to encourage Laclede to spend as little as necessary on premiums and to reduce the overall cost of the program.

During the 2000-2001 time period, high natural gas prices led Laclede to declare in June of 2000 that it would not exercise the Price Protection Incentive component of the Price Stabilization Program. To opt out meant that Laclede would not retain any gains nor incur any losses which resulted from the purchase of price protection.

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Laclede continued to buy and sell call options during the 2000-2001 winter heating season. The natural gas company, under the Overall Cost Reduction Incentive portion of the Price Stabilization Program, used a formula to calculate what it believed to be its share of the net proceeds (approximately $4.9 million). The Commission, however, has determined that those proceeds should not go to Laclede's shareholders but to Laclede customers stating that when Laclede opted out of the Price Protection Incentive component of the Price Stabilization Program it was in essence opting out of the Overall Cost Reduction Incentive portion as well.

The Commission stated in its decision that the Price Stabilization Program contained two, closely interrelated incentive features that were designed to maximize the protection afforded to customers, while minimizing the cost of that protection. The Commission stated in its order: "When both incentive clauses were working the program and tariff made sense. Both Laclede and its customers could benefit from the sale of call options. Both could receive a share of profits, but more importantly, Laclede's customers received the benefit of having price protection against an unexpected increase in natural gas prices. Unfortunately, when natural gas prices skyrocketed beginning in May of 2000, Laclede was in a position where it had to withdraw from the Price Protection Incentive portion of the Price Stabilization Program. Consumers were left without the price protection to which they were entitled under the program."

The Commission further noted that without the price protection function of the Price Protection Incentive element of the Price Stabilization Program, "the Overall Cost Reduction Incentive was merely a meaningless vestige." The Commission continued: "Intermediate trading of call options did not necessarily provide any price protection to Laclede's customers. Laclede could sell its hedge positions at any time and collect and keep a portion of the proceeds. Meanwhile, the price of natural gas used by those customers could keep rising after Laclede had sold out of its hedge position, leaving the customers unprotected."

The Commission noted in its order that there is no reason to believe that Laclede was in any way blameworthy because of its decision to withdraw from the Price Protection Incentive element of the program. "Certainly, Laclede was not responsible for the spike in natural gas prices that shocked consumers in the winter of 2000-2001. However, there is no reason to believe that Laclede should be allowed to share in the illusory profits it made from trading in call options while the price that consumers had to pay for natural gas soared."

Laclede Gas Company serves approximately 635,450 natural gas customers in the City of St. Louis as well as the Missouri counties of St. Louis, St. Charles, Butler, Iron, Franklin, Jefferson, Madison, St. Francois and Ste. Genevieve.

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Case Nos. GR-2001-387 & GR-2000-622